



Investment Management ADVISORY ■

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SEC Updates the Definitions of “Accredited Investor” and “Qualified Institutional Buyer”

On August 26, 2020, the Securities and Exchange Commission (SEC) adopted [amendments](#) to update and expand the definitions of “accredited investor” and “qualified institutional buyer” (QIB). The amendments add new categories and modify existing ones for each definition, expanding the number of natural persons and entities that qualify as an accredited investor or QIB. The updated definitions should be of great interest to investment fund managers because they expand access to private markets for entities and individuals that would not have previously qualified as an accredited investor or QIB and because they are part of the SEC’s larger effort to more effectively identify certain classes of investors that have the knowledge and expertise to participate in private capital markets.

Whereas the prior accredited investor standard for individual investors was based exclusively on a person’s income and/or net worth (except for those investors that were also executive officers or general partners of the issuer of the securities being offered or sold, or any directors, executive officers, or general partners of a general partner of that issuer), the new definition includes additional categories for financially sophisticated individuals that may not strictly meet the income and net worth definitions of an accredited investor but nevertheless possess the necessary knowledge and expertise, by virtue of professional credentialing, educational background, or official capacity within a fund organization, to assess an investment opportunity. Among those who will now qualify as accredited investors are individuals holding certain professional certifications (including Series 7, Series 65, and Series 82 licenses) as well as those holding certain credentials from accredited educational institutions that the SEC has designated as qualifying an individual for accredited investor status. Additionally captured by the new accredited investor categories are SEC and state-registered investment advisers, exempt reporting advisers, and knowledgeable employees of private funds.

SEC Chairman Jay Clayton noted that these changes will “add much needed flexibility to the definition of ‘accredited investor’ by adding new categories of qualifying individuals and entities that have demonstrated financial sophistication such that they should not be excluded from the very large, multifaceted and important private capital markets. The private capital markets are important to investors and issuers of various types, as well as our economy more generally. The accredited investor definition is the principal test for investor participation in significant segments of our private capital markets.”

These amendments will directly expand the pool of potential investors that fund managers may access for private offerings of securities.

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In reaction to the amendments, managers of private equity, hedge, and venture capital funds should update the accredited investor and QIB questionnaire components of offering documents and subscription materials to align with the expanded categories. These funds should also reassess their investor onboarding requirements to allow for these more easily verified investor credentialing criteria based on the expanded definition.

Despite public comment urging and the views of certain SEC commissioners, the SEC notably did not increase the existing financial thresholds for income and net worth requirements set forth in the existing accredited investor definition.

Natural Persons Holding Professional Certifications and Designations or Other Credentials

The SEC will evaluate whether or not a particular certification allows a natural person to qualify as an accredited investor because they hold a professional certification or designation or credential in good standing from an accredited educational institution that the SEC has designated as qualifying for accredited investor status. In conducting this evaluation, the SEC will consider this nonexclusive list of attributes:

- The certification arises out of an examination that is administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution.
- The examination evaluates an individual's comprehension and sophistication in securities and investing.
- Persons with such certification can be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment.
- The relevant self-regulatory organization or other industry body makes publicly available an indication that an individual holds the certification.

Initially, the SEC expects to issue an order accompanying the final rule that will include the following certifications administered by the Financial Industry Regulatory Authority (FINRA) as qualifying under the accredited investor definition: the Licensed General Securities Representative (Series 7), Licensed Investment Adviser Representative (Series 65), and Licensed Private Securities Offerings Representative (Series 82). In the future, the SEC will designate other certifications, designations, or credentials as qualifying credentials through an order with applicable notice periods and opportunity for public comment before the order is issued.

"Knowledgeable Employees" of Private Funds

Knowledgeable employees as defined in Rule 3c-5(a)(4) under the Investment Company Act of 1940, as amended, (ICA) of a private fund will qualify as accredited investors. Rule 3c-5(a)(4) under the ICA defines a "knowledgeable employee" of a private fund as:

- (i) an executive officer, director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the private fund or an affiliated management person (as defined in Rule 3c-5(a)(1)) of the private fund; and
- (ii) an employee of the private fund or an affiliated management person of the private fund (other than an employee performing solely clerical, secretarial or administrative functions...) who, in connection with his or her regular functions or duties, participates in the investment activities of such private fund, other private funds, or investment companies the investment activities of which are managed by such affiliated management person of the private fund ... for at least 12 months.

This amendment provides a technical fix to the accredited investor definition to harmonize it with the “qualified purchaser” definition under the ICA. Previously, an individual could be a knowledgeable employee of a particular private fund as defined under Rule 3c-5 but nevertheless could *not* qualify under the net worth or income tests or was not otherwise a director, executive officer, or general partner of the private fund, and therefore would not meet the definition of an accredited investor. The knowledgeable employee would therefore have been ineligible to invest in the private fund as an accredited investor despite that person’s familiarity with the private fund’s investments and operations.

“Family Offices” and Their “Family Clients”

In order to qualify as an accredited investor, the family office must have at least \$5 million in assets under management and have not been formed for the specific purpose of acquiring the securities offered, and its prospective investment must be directed by a person who has enough knowledge and experience in financial and business matters that the family office is capable of evaluating the merits and risks of the prospective investment.

A family office under Rule 202(a)(11)(G)-1 of the Investment Advisers Act of 1940, as amended, is generally a company whose sole clients are “family clients,” which are generally family members, former family members, and certain key employees of the family office, as well as certain charitable organizations, trusts, and other types of entities.

Consideration of Joint Income

The amendments will further expand the pool of potential investors by allowing natural persons to include joint income from spousal equivalents when calculating joint income under Rule 501(a)(6) and to include spousal equivalents when determining net worth under Rule 501(a)(5) under the Securities Act of 1933, as amended. A “spousal equivalent” is defined as a cohabitant occupying a relationship generally equivalent to that of a spouse.

Additional new categories include:

- SEC and state-registered investment advisers and exempt reporting advisers.
- Rural business investment companies (RBIC). RBICs are companies that are approved by the Secretary of Agriculture and promote economic development and wealth creation in rural areas. Small business investment companies share a common purpose of promoting capital formation with RBICs and are already recognized as accredited investors. The amendment creates equal treatment for the two types of entities.
- Limited liability companies (LLC) that have total assets exceeding \$5 million and were not formed for the specific purpose of acquiring the securities being offered.
- Any entity owning “investments,” as defined in Rule 2a51-1(b) under the ICA, exceeding \$5 million that is not formed for the specific purpose of acquiring the securities being offered.

Qualified institutional buyer changes

The definition of a QIB has been updated to reflect some of the updates to the accredited investor definition. It is important, however, to note that the QIB definition has not been expanded to include family clients, clients of SEC-registered advisers, or private funds with \$100 million in gross asset value.

QIB status is determined under Rule 144A(a)(1)(i) of the Securities Act, which specifies the types of institutions that are eligible, if they meet the \$100 million in securities owned and invested threshold. The final rule will add the following categories to the definition of a QIB:

- Rule 144A(a)(1)(i) is amended to include RBICs and LLCs in the definition of a QIB to correspond with the changes to the accredited investor definition.
- A new paragraph (J) is added allowing institutional accredited investors under Rule 501(a) that are not specifically listed in Rule 144A to qualify as QIBs once they satisfy the \$100 million threshold. This new paragraph is intended to capture entities such as Indian tribes, governmental bodies, and bank-maintained collective investment trusts.

The amendments and order become effective 60 days after publication in the *Federal Register*. Alston & Bird is prepared to assist fund managers and funds in appropriate evaluation and revision of all offering and compliance materials.

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